MONTANA MONEY SCHOOL

State Auditor John Morrison

# Individual Retirement Accounts

## IRAs

You can start planning early for your retirement by contributing money each year to an Individual Retirement Account or IRA. An IRA is an investment account that you open through a bank, brokerage firm or mutual fund.

IRAs are called Individual Retirement Accounts because you open them in your own name. There's no such thing as a joint IRA, even for married couples. You use an IRA account to buy investments, such as stocks, bonds and mutual fund shares. Those investments will grow tax-deferred or tax-free, depending on the IRA. You can withdraw your funds without penalty anytime after you turn 59½.

## Maximum Investment

All IRA contributions must come from your earned income, including wages, salaries, tips and bonuses. Through 2001, the federal tax code limited IRA contributions to $2,000 per year. However, as a result of recent tax changes, the maximum IRA contribution increased to $3,000 for 2002-2004, $4,000 for 2005-2007, and to $5,000 in 2008. After that, the maximum contribution will be indexed for inflation until 2010 when the new tax law is scheduled to expire.

If you and your spouse are employed, you can contribute the maximum amount to your own IRA each year. If only one of you is employed, you can set up a regular IRA for the working spouse and a spousal account for the non-working spouse.

You don't have to deposit the same amount of money in your IRA each year. You can even make contributions to more than one IRA. However, one person's total IRA contribution can't exceed the maximum contribution level in any one year.

## The Traditional IRA

This IRA, created in 1974, lets you defer paying taxes on your IRA earnings until you withdraw the money from that account in retirement. Depending on your income, and whether you belong to a pension plan at work, you also may be able to deduct your annual IRA contributions from your taxable income each year.

The Traditional IRA has several rules governing contributions and withdrawals:

- With limited exceptions, you can't begin withdrawing money from this IRA without penalty until you reach 59½.
- You must start withdrawing money from this IRA – and paying taxes on that money when you turn 70½.
- If you fail to make withdrawals on schedule, or don't withdraw enough money, you will pay a penalty.
- You can't contribute any more money to this IRA after you reach age 70½.

## The Roth IRA

If you qualify to open a Roth IRA, which was established in 1997, you will never pay taxes on the income you earn through your IRA investment as long as your withdrawals comply with IRS rules. This means that your earnings from a Roth IRA grow tax-free. In addition, these rules apply:

- You can't deduct your annual Roth contributions from your taxable income.
- You can't start using your Roth earnings until you turn 59½.
- You don't have to withdraw money from the account, or pay any additional taxes, when you turn 70½.
- You can keep contributing money to the IRA for as long as you have earned income.

## Internal Revenue Service

IRS regulations affect your ability to save through a Traditional or Roth IRA. IRS publication 590: Individual Retirement Arrangements, is available by calling 1-800-829-3676 or you can read it online at www.irs.gov. At the left-hand side of the IRS homepage enter publication 590 in the search query for forms and publications.

Which IRA is best for you will depend on your financial situation, including your tax bracket, other income sources, and other investments. To be sure, check with a tax specialist.

SOURCE: AARP "Future Focus, Your Guide To Financial Planning For Retirement."